SAUDI ARABIA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP 2/	136.0	145.9	125.0
Real GDP Growth (pct) 3/	1.4	2.7	N/A
GDP by Sector:			
Agriculture	N/A	N/A	N/A
Manufacturing (including oil)	N/A	N/A	N/A
Services	N/A	N/A	N/A
Government	N/A	N/A	N/A
Per Capita GDP (US$)	6,900	7,200	6,100
Labor Force (millions)	7.2	6.7	6.5
Unemployment Rate (pct)	N/A	N/A	N/A
Money and Prices (annual percentage growth):			
Money Supply Growth (M2)	9.9	7.0	1.6
Consumer Price Inflation	1.5	-0.4	-0.2
Exchange Rate (SR/US$ annual average)			
Official	3.75	3.75	3.75
Balance of Payments and Trade:			
Total Exports FOB 4/	N/A	N/A	N/A
Exports to U.S. 5/	8.9	9.4	5.1
Total Imports CIF 4/	N/A	N/A	N/A
Imports from U.S. 5/	7.3	N/A	6.3
Trade Balance 4/	N/A	N/A	N/A
Balance with U.S. 5/	1.2	N/A	1.2
Current Account Deficit/GDP (pct)	0	0	11.2
External Public Debt 6/	0	0	4.3
Debt Service Payments/GDP (pct)	N/A	N/A	N/A

Fiscal Deficit/GDP (pct)	3.3	1.1	8.8
Gold and Foreign Exchange Reserves	16.9	17.8	N/A
Aid from U.S.	0	0	0
Aid from All Other Sources	0	0	0

1/ 1998 figures are all estimates based on available data in October.

2/ GDP at factor cost.

3/ Percentage change calculated in local currency.

4/ Merchandise trade.

5/ Source: U.S. Department of Commerce and U.S. Census Bureau; exports FAS, imports customs basis; 1998 figures are estimates based on data available through August.

6/ Does not include debt owed by parastatal corporations.

1. General Policy Framework

Saudi Arabia generally sets a framework for a free market economy. Government policies tend to encourage commercial enterprise, but a strict interpretation of Islamic mores limits the range of policy options as well as that of commercial endeavors. Since about 1970, Saudi Arabia has published a series of five-year development plans, focusing on infrastructure and industrialization. Development plans, however, are presented as planning tools, not as centralized controls, and the government takes pains to exhort that its development plans rely on heavy private sector involvement.

The oil and government sectors are the engines of the economy. Parastatal enterprises, including Saudi ARAMCO (oil) and Saudi Basic Industries Corporation (SABIC), among others, tend to dominate the corporate economy. Spending decisions taken by the few large state companies reverberate throughout the economy. Concerned with the security challenges posed by neighbors such as Iran and Iraq, Saudi Arabia seeks sufficient military and security resources to protect its territory. The Saudis also protect the pilgrims who visit the two Islamic holy cities of Mecca and Medina. These requirements have made the kingdom a large buyer of advanced military technology, as manpower resources are limited.

In 1997, oil sector revenues comprised an estimated 42 percent of GDP, and an estimated 75 percent of budget revenues. Other government revenues, including items such as customs duties, investment income, and fees for services, are to a large degree indirectly tied to oil, as capital available for consumption and investment is generally derived from oil receipts. In addition, the manufacturing and services sectors are largely dependent on petroleum and petrochemical activities.

Starting with the oil boom of the early 1970s, Saudi Arabia maintained annual budget surpluses until 1983, when the decline in oil prices led to a renewed deficit. These deficits have continued for the past 15 years. Initially, the deficits were financed by a drawdown of foreign exchange reserves. Starting in 1987, the government began financing deficits by issuing government bonds, and taking loans from domestic banks. The government has also accrued substantial arrearages to the private sector over the past decade, though these were paid down substantially in 1996 and 1997 with unanticipated oil revenues from these years.

Spending in 1996 exceeded the budgeted target by $12 billion, but because of high oil revenues, the government achieved its deficit target of $4.5 billion. Oil revenues were higher than anticipated for 1997 as well, allowing the government to end the year with a small $1.6 billion deficit. However, the collapse in oil prices in late November 1997 brought this favorable fiscal trend to an end. Saudi oil revenues are expected to drop by one-third in 1998. The government's hopes of achieving a balanced budget by 2000 appear problematical.

Money supply is regulated through the Saudi Arabian Monetary Agency (SAMA), which has statutory authority to set monetary reserve requirements for Saudi Arabian banks, impose limits on their total loan portfolio, and regulate the minimum ratio of domestic assets to their total assets. It also manages the bond market, and can repurchase development bonds and treasury bills as required. There is a limit to the amount of bonds that can be repurchased. SAMA oversees a financial sector consisting of 11 commercial banks. The Ministry of Finance oversees five specialized credit institutions.

2. Exchange Rate Policy

The exchange rate for the Saudi Arabian Riyal is SR 3.75 = US$1.00. This rate has been consistent since 1986. Officially, the riyal is pegged to the IMF's Special Drawing Rights (SDR) at SR 4.28255 = SDR 1. There are no taxes on the purchase or sale of foreign exchange.

Generally speaking, there are few foreign exchange controls for either residents or nonresidents, in keeping with the government policy to encourage an open economy. Of the few restrictions, the most noteworthy are: commercial transactions with Israel and Israeli-registered corporations are prohibited, as are most transactions with Iraq; and, local banks are prohibited from inviting foreign banks to participate in riyal-denominated transactions without prior SAMA approval.

3. Structural Policies

The government maintains price controls for basic utilities, energy, and many agricultural products. Water and electricity, for most consumers, are subsidized, with consumer prices often well below the cost of production, especially for potable water. Petroleum products and feedstocks for petrochemical industries are provided at below world market pricing, reflecting discounts for efficiencies in production and transport. The government maintains that local petroleum prices that are below world market averages (e.g., a gallon of gasoline sells for $.60 at the pump) reflect the low costs of production. Nonetheless, the effect of these low prices is that petroleum products, including many petrochemicals, are sold in Saudi Arabia at prices that effectively eliminate competing imports. Agricultural subsidies were dramatically curtailed in the early 1990s and have been reduced in the two most recent budgets, in line with the government's deficit reduction plans and its goal to reduce water consumption.

The Saudi Arabian Government imposes few taxes, relying on oil revenues, customs duties, and licensing fees for most government revenue. Saudi Arabian nationals pay no income tax, but are obliged to pay "zakat," a 2.5 percent Islamic assessment based on net wealth (not income). Zakat is designed to support the Islamic community (e.g., to pay for hospitals, schools, support for the indigent). Foreign companies and self-employed foreigners pay an income tax, but do not pay zakat. Business income tax rates range from 25 percent on annual profits of less than $26,667 to a maximum rate of 45 percent for profits of more than $266,667. Some foreign investors avoid taxation either in part or totally, by taking advantage of various investment incentives, such as 10-year tax holidays for investments in approved projects meeting specified requirements. Import tariffs are generally 12 percent ad valorem (CIF), except on products imported from other member states of the Gulf Cooperation Council, which pay no tariff. Certain specified essential commodities (e.g., defense purchases) are not subject to custom duties. Saudi Arabia also levies a maximum 20 percent tariff on products that compete with local "infant" industries.

4. Debt Management Policies

Saudi Arabia is a net creditor in world financial markets. SAMA manages foreign assets of over $50 billion in its issues and banking departments, and an estimated $20 billion for autonomous government institutions, including the Saudi Pension Fund, the Saudi Fund for Development, and the General Organization for Social Insurance. Under SAMA's rules, about $17 billion of the $50 billion in foreign assets is designated to guarantee the Saudi Riyal. In addition to overseas assets managed by SAMA, the commercial banking system has an estimated net foreign asset position of $12.0 billion.

Foreign debt, which stood at a level of $1.8 billion at the beginning of 1995, was retired in May of that year. Domestic banks, Saudi ARAMCO, and other state-owned enterprises, however, have overseas liabilities.

Government domestic borrowing has a short history in Saudi Arabia. The government began borrowing to finance budget deficits in 1987 by selling government development bonds having two-to-five year maturities. After the massive defense expenditures of the 1991 Gulf War, the government expanded its borrowing by signing loan syndications with international and domestic banks, and by introducing treasury bills. This debt, owed almost entirely to domestic creditors, such as autonomous government institutions, commercial banks, and individuals, ballooned to about $120 billion by mid-1998, or near the GDP level. In addition, the government issued a series of bonds to farmers and some other private sector creditors (mainly contractors) for past due amounts. Paying down this debt is now a focus of government concern.

5. Significant Barriers to U.S. Exports

Saudi Arabia is currently in the process of negotiating accession to the World Trade Organization (WTO). A number of current regulations have the potential to restrict entry of U.S. exports and investments.

Import licensing requirements protect Saudi Arabian industries or enhance Saudi Arabian businesses. In most cases, foreign companies must operate through a Saudi Arabian agent. Contractors for public projects must purchase equipment and most supplies through Saudi agents. (This agency requirement does not apply to defense-related imports.) Saudi Arabia requires licenses to import agricultural products.

The recently implemented preshipment inspection regime, known as the International Conformity Certification Program (ICCP), is designed to protect Saudi Arabian consumers from shoddy foreign products. The ICCP has elements which can be viewed as barriers to free trade -- such as an ad valorem-based fee schedule -- and remains controversial. It adds inspection costs to imported civilian products, may delay shipments to Saudi Arabia, and can increase exporter overhead.

Restrictions on shelf life labeling standards in Saudi Arabia may make it difficult for some U.S. food producers to compete in the Saudi market.

Saudi Arabia gives preference to imports from other members of the Gulf Cooperation Council (GCC) in government purchasing, with a 10 percent price preference over non-GCC products for government procurement.

Saudi Arabia requires foreign civilian contractors to subcontract 30 percent of the value of government non-military contracts, including support services, to firms having Saudi-majority ownership. Many firms have reported that this has not been enforced consistently. Some U.S. businessmen have complained that this is a barrier to the export of U.S. engineering and construction services. Other service industries are restricted to government-owned companies, e.g., certain insurance and transportation services.

The "Investment of Foreign Capital Regulation" establishes the following conditions for a non-Saudi national to obtain a license for a business and for investment of foreign capital:

a. Foreign capital must be invested in a development project, or in projects within the framework of the development plan in effect at the time of the investment. Investments in oil and mineral sectors are subject to special regulations of the Ministry of Petroleum and Mineral Resources.

b. Foreign capital investment must be accompanied by foreign technical expertise. In addition, the "foreign capital investment committee," established by the "investment of foreign capital regulation," reviews license applications. The committee's screening of foreign investments is general; the criteria for screening, other than the two conditions listed above, appear to be limited to:

-- Ensuring that an investment does not violate the social or religious mores of Saudi Arabia.

-- Regulating the number of establishments in any one sector, to the level that the market will sustain.

There is no requirement that a non-Saudi investor have a Saudi partner. At the same time, businesses having a minimum of 25 percent Saudi ownership are eligible for soft government loans, which are generally unavailable to firms lacking Saudi ownership. The government is currently reviewing foreign investment and agency regulations.

Saudi labor law requires companies to employ Saudi nationals, but foreigners account for 95 percent of the private sector labor force. Small companies are supposed to be exempt from the requirement, and larger companies are required to increase their percentage of Saudi employees by a certain percentage annually or face restrictions. This emphasis on "Saudiization" is increasing as the number of unemployed/underemployed Saudis increases.

6. Export Subsidies Policies

Saudi Arabian planners say that there are no export subsidy programs for industrial projects. Because feedstock prices are relatively low in Saudi Arabia, industrial production of petroleum and related downstream products is comparatively attractive. The government argues that this is simply a reflection of the low cost of domestic oil production. On January 1 1998, the Saudi Government announced a 50 percent across-the-board increase in natural gas prices from $.50/million btu to $.75/million btu. The government has reduced subsidies to agriculture, which has resulted in reduced agricultural production available for export.

7. Protection of U.S. Intellectual Property

Saudi Arabia has applied to join the World Trade Organization (WTO), and as a new member, it will be required to meet obligations under the WTO's Trade Related Aspects of Intellectual Property (TRIPs) immediately upon accession. Saudi Arabia is a member of the World Intellectual Property Organization (WIPO), but is not a contracting party to any of the treaties administered by WIPO. As of late 1998, Saudi Arabia remains on the USTR's "Watch List," having moved in 1996 from the "Special 301" program's "Priority Watch List" in recognition of progress made in intellectual property rights protection. The concept of intellectual property protection is relatively new to Saudi Arabia. The government has enacted some Intellectual Property (IP) regulations and has joined the Universal Copyright Convention, but efforts to protect intellectual property rights are uneven. Audio, video and software companies see a need for greater protection of their products in the Kingdom.

Saudi Arabia has enacted a patent regulation and established a patent office. The regulation was patterned along the lines of the U.S. patent law, but does not reproduce it. The terms of patent protection are generally adequate, but the period of protection is 15 years, five years less than the international TRIPs standard. The regulation permits compulsory licensing if the patent holder refuses to use the patent, or for other public policy reasons, on a wider basis than permitted under TRIPs. Further, the Saudi Patent Office is functionally inactive. The office has received several thousand patent applications since 1989, but has completed action on only about 10. The patent office lacks sufficient manpower to process the backlog of applications. A parallel patent office was established by the Gulf Cooperation Council (GCC) in October, 1998.

The embassy has noted a significant increase in trademark infringement complaints, particularly those involving consumer products. Registration is relatively uncomplicated, although some companies have complained that registration and search fees are high. Although legal remedies for infringement of a trademark exist, enforcement of trademark protection is inconsistent.

The embassy has received no verifiable reports of book piracy, and only one report of the unlicensed use of a published photograph. Piracy of U.S. produced audio and video cassettes has decreased due to government enforcement polices but remains a problem. Estimates of losses to computer software companies due to illegal copying vary widely, but are generally considered high.

8. Worker Rights

a. The Right of Association: Saudi regulations prohibit labor associations.

b. The Right to Organize and Bargain Collectively: Much skilled and almost all unskilled labor is performed by expatriates. Non-Saudi workers who seek to organize may be deported.

c. Prohibition of Forced or Compulsory Labor: Forced labor is prohibited. However, as most unskilled labor is performed by expatriates, and as Saudi employers have legal authority over the movement of their contracted laborers, implicit forced labor may occur, especially in the case of domestic servants and in remote areas. In 1997 and 1998, the government expelled many workers without proper work permits. One result of this may be to reduce the potential for abuse.

d. Minimum Age for Employment of Children: The labor law states that "a juvenile who has not completed 13 years of age shall not be employed." The minimum age for employment, therefore, is 14 hijri years. This restriction may be waived by application to the Ministry of Labor with the consent of the juvenile's parent or guardian. Children under 18 and women may not be employed in hazardous or unhealthy occupations. Wholly-owned family businesses and family-run farms are exempt from these rules.

e. Acceptable Conditions of Work: Saudi Arabian authorities consider that provisions of Islamic Law (the Shariah) provide more than adequate protection for laborers, and therefore additional regulation is unnecessary. Conditions of labor, while far from perfect, may in some cases be better than those found in countries from which most poorer expatriates come. Although Saudi Arabia has no minimum wage, generally speaking, expatriate laborers come to Saudi Arabia because they can earn more than they could at home. They receive time-and-one-half for hours (up to 12) over the 44 hours normally worked per week. The labor law requires employers to provide health insurance and to protect workers from job-related hazards and diseases.

f. Rights in Sectors with U.S. Investment: Worker rights in sectors with U.S. investment do not differ from those elsewhere. Conditions of work at major U.S. firms and joint-venture enterprises are generally better than elsewhere in the Saudi economy. Workers in U.S. firms normally work a five to five-and-one-half day week (i.e., 44 hours) with paid overtime. Overall compensation tends to be at levels that make employment with U.S. firms attractive.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		298
Total Manufacturing		139
Food & Kindred Products	13	
Chemicals & Allied Products	56	
Primary & Fabricated Metals	16	
Industrial Machinery and Equipment	1	
Electric & Electronic Equipment	1	
Transportation Equipment	4	
Other Manufacturing	49	
Wholesale Trade		86
Banking		(1)
Finance/Insurance/Real Estate		1,453
Services		(1)
Other Industries		330
TOTAL ALL INDUSTRIES		3,079

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.